Pension Funding

City of Torrance, CA

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Understanding Pension Funding

Pension Basics

Hurdles and Other Considerations

How is your agency doing relative to your funding targets?

Next Steps

Pension Basics

Pension Jargon Glossary

- Assumption = Target, Goals or Expected Results
- Experience = Actual Results
- Discount Rate = Long-term *assumed* Investment Rate of Return
- Normal Cost = Initial savings rate (Employee and Employer contributions)
- Amortization of UAL = Annual amount needed to get back on track
- Annual Required Contribution = Normal Cost + Amortization of UAL
- Present Value of Projected Benefit (PVPB) = Savings goal at desired retirement age
- Accrued Liability (AL) = Target funding progress at a given point of time
- Unfunded Accrued Liability (UAL) = Amount actual savings falls short of funding goal

Retirement Benefits

Provided through California Public Employees Retirement System (CalPERS), a multi-employer pension & health care administrator

Promised benefit is made by the contracting agency and thus the local agency’s obligation not CalPERS

Once the promised benefit is made, the benefit can only be changed prospectively per the California Constitution “California Rule”

Exiting CalPERS is not a practical option, the termination liability is cost prohibitive.

Revised benefit structure for employees hired on or after January 1, 2013 due to Public Employees Pension Reform Act (PEPRA)

Torrance has 3 CalPERS plans: Miscellaneous, Safety Police, Safety Fire.

Benefit Tiers – Miscellaneous Employees

	Miscellaneous Tier 1	*Miscellaneous 2010 Tier*	*Miscellaneous Tier 3 PEPRA*
Hire Date	Before 2010 Tier created (Aug 2010-Feb 2011)	After Aug 2010-Feb 2011; depending on MOU	On or after 1/1/13
Formula	2% @ 55	2% @ 55	2% @ 62
Final Pay Period	12 Months	12 Months	36 Months
COLA	2% per year	2% per year	2% per year
Employee Contributions	Employer Paid Member Contribution (EPMC) 7%	Employee Pays 7% of Pensionable Compensation	Employee Pays 6.75% of Pensionable Compensation

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Benefit Tiers – Safety Police

	Safety Police Tier 1	*Safety Police 2010 Tier*	*Safety Police Tier 3 - PEPRA*
Hire Date	Before 2010 Tier created (Mar 2011-Jan 2012)	After Mar 2011-Jan 2012; depending on MOU	On or after 1/1/13
Formula	3% @ 50	3% @ 50	2.7% @ 57
Final Pay Period	12 Months	12 Months	36 Months
COLA	2% per year	2% per year	2% per year
Employee Contributions	Employer Paid Member Contribution (EPMC) 9%	Employee pays 9% of Pensionable Compensation	Employee Pays 12.50% or 14.75% of Pensionable Compensation

Benefit Tiers – Safety Fire

	Safety Fire Tier 1	*Safety Fire 2010 Tier*	*Safety Fire Tier 3 - PEPRA*
Hire Date	Before 2010 Tier created (Mar 2011-Jan 2012)	After Mar 2011-Jan 2012; depending on MOU	On or after 1/1/13
Formula	3% @ 50	3% @ 50	2.7% @ 57
Final Pay Period	12 Months	12 Months	36 Months
COLA	2% per year	2% per year	2% per year
Employee Contributions	Employer Paid Member Contribution (EPMC) 9%	Employee Pays 9%of Pensionable Compensation	11.25% or 12% of Pensionable Compensation

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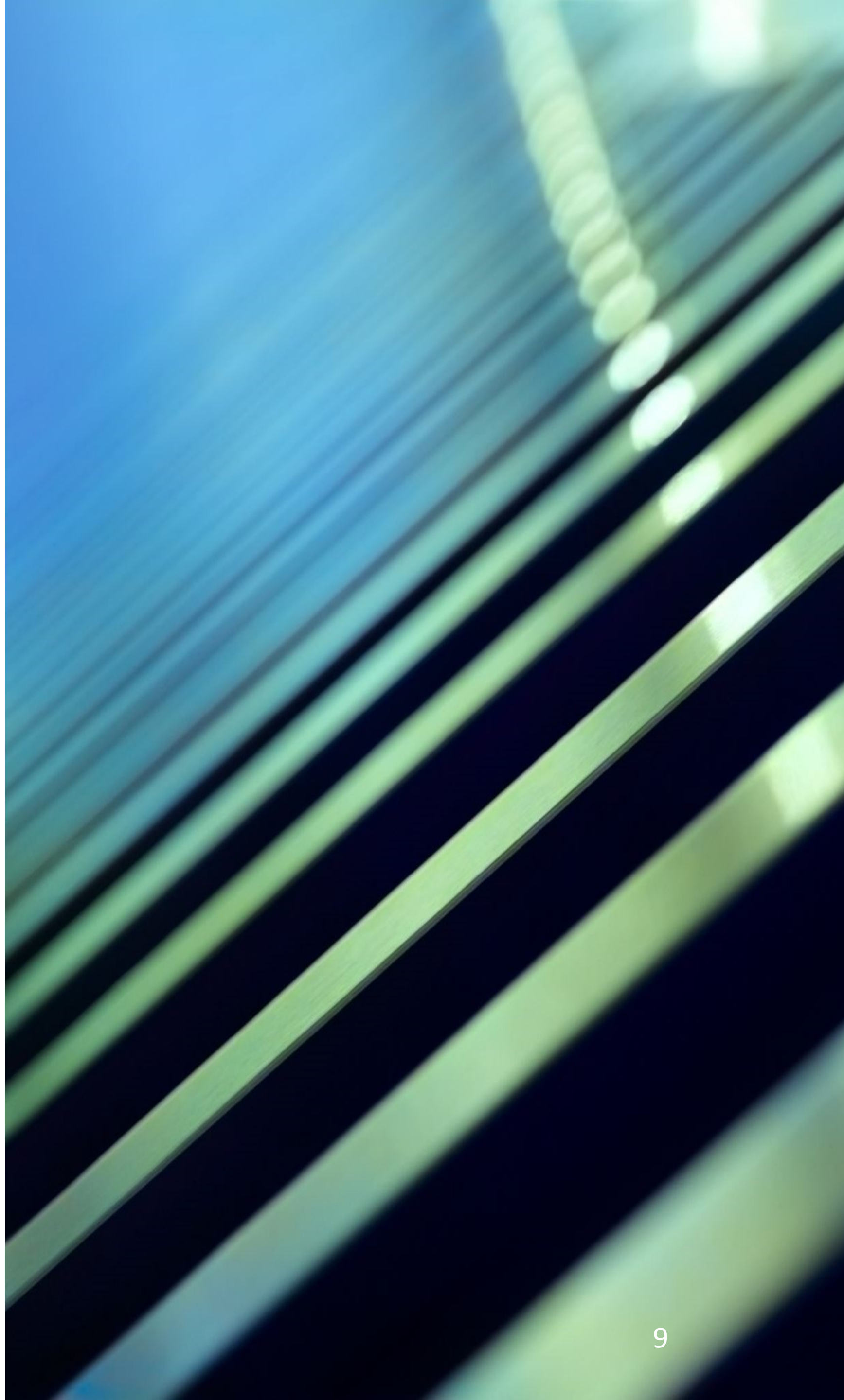
Defined Benefit – Sample

What does 2.0 @ 55 Mean?

- 2.0 is the benefit factor if employee retires at age 55.
- The benefit factor is multiplied times the years of service to derive a % of pensionable pay
  - Pensionable pay **<u>does not</u>** include any accrual cash outs or overtime payments made to employees.
  - SCO GCC Report and Transparent California reported compensation is **<u>not</u>** necessarily all eligible for pension calculations
- 30 Years of Service X 2.0 = 60% of Final Year
  - Final Year of $100,000 = $60,000 Lifetime Annual Benefit
- Employees could retire as early as 50 and receive a reduced benefit factor.
  - For example: 1.9% at age 54, 1.7% at age 53, 1.6%



Employee Count by Benefit Group*

Breakdown of Groups

Total	Classic With EMPC**	Classic "2010" Without EPMC*	PEPRA
1,199	627	103	469

Ratio	52%	9%	39%

*Excludes Seasonal/Recurrent Employees
**Employer Paid Member Contributions (EPMC)

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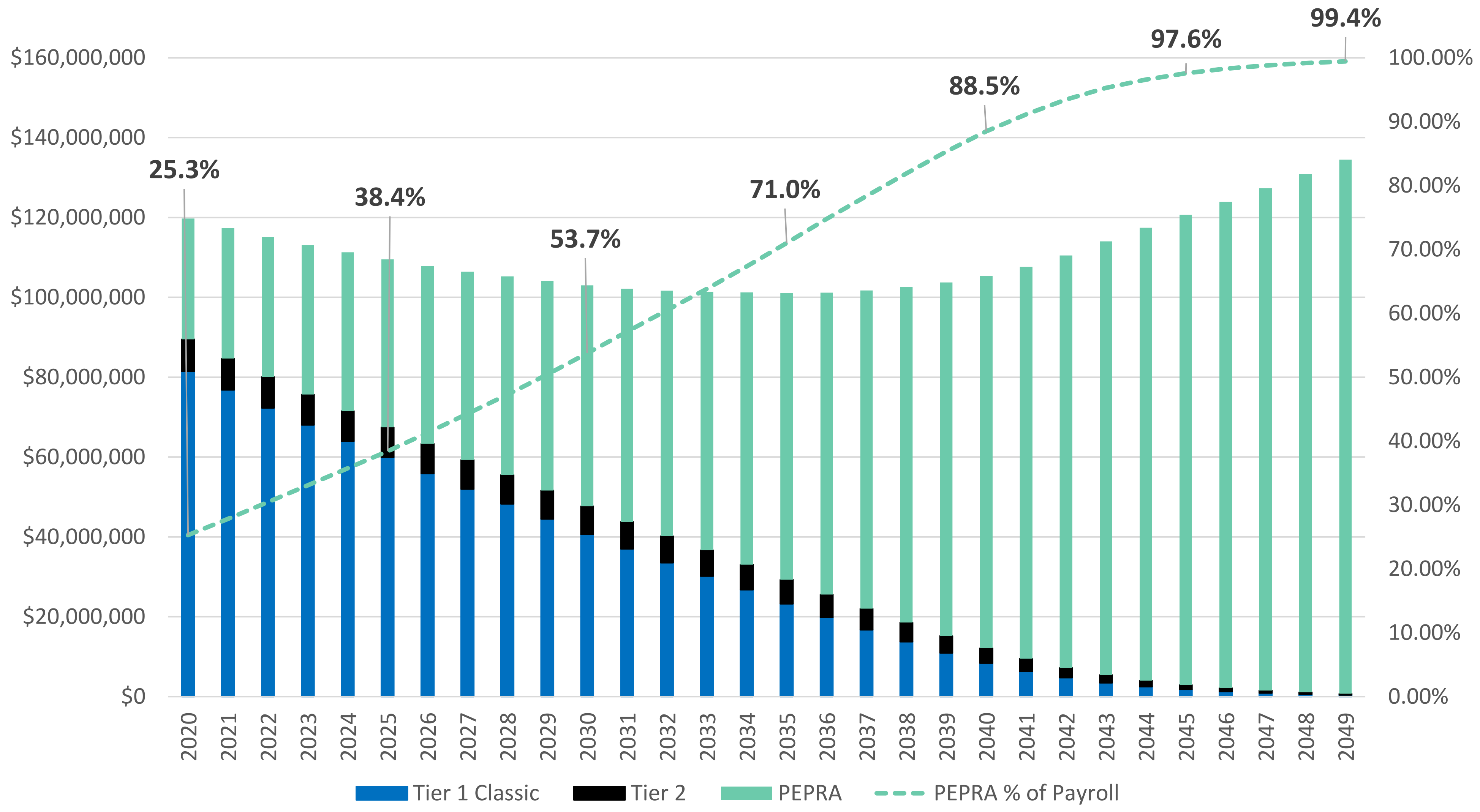
Projected Transition From Classic Benefit to PEPRA



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Actuarially Determined Contribution

Normal Cost + Unfunded Actuarial Liability (UAL) Amortization Payment = Total Employer Contribution

Normal Cost – the cost for current service paid as a percent of payroll. Increases when payroll increases, decreases when payroll decreases

UAL Contribution – payment toward past service. Paid as a fixed dollar amount each year.

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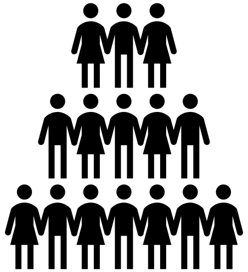
Assumptions Set Future Cost & Funding Expectations



Economic

- Inflation
- Investment Return
- Salary Growth

Demographic

- Retirement
- Disability
- Death
- Termination

Major Driver of Plan Cost and Affordability

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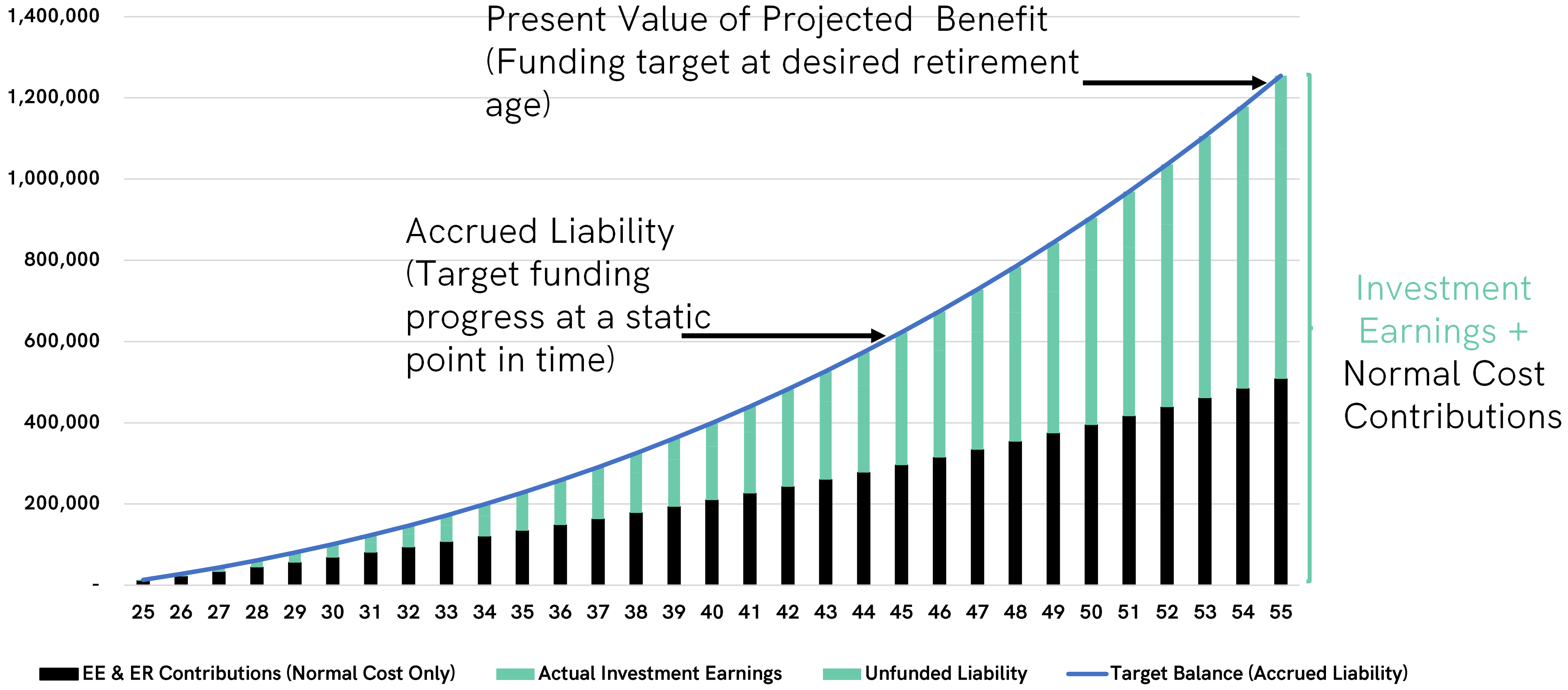
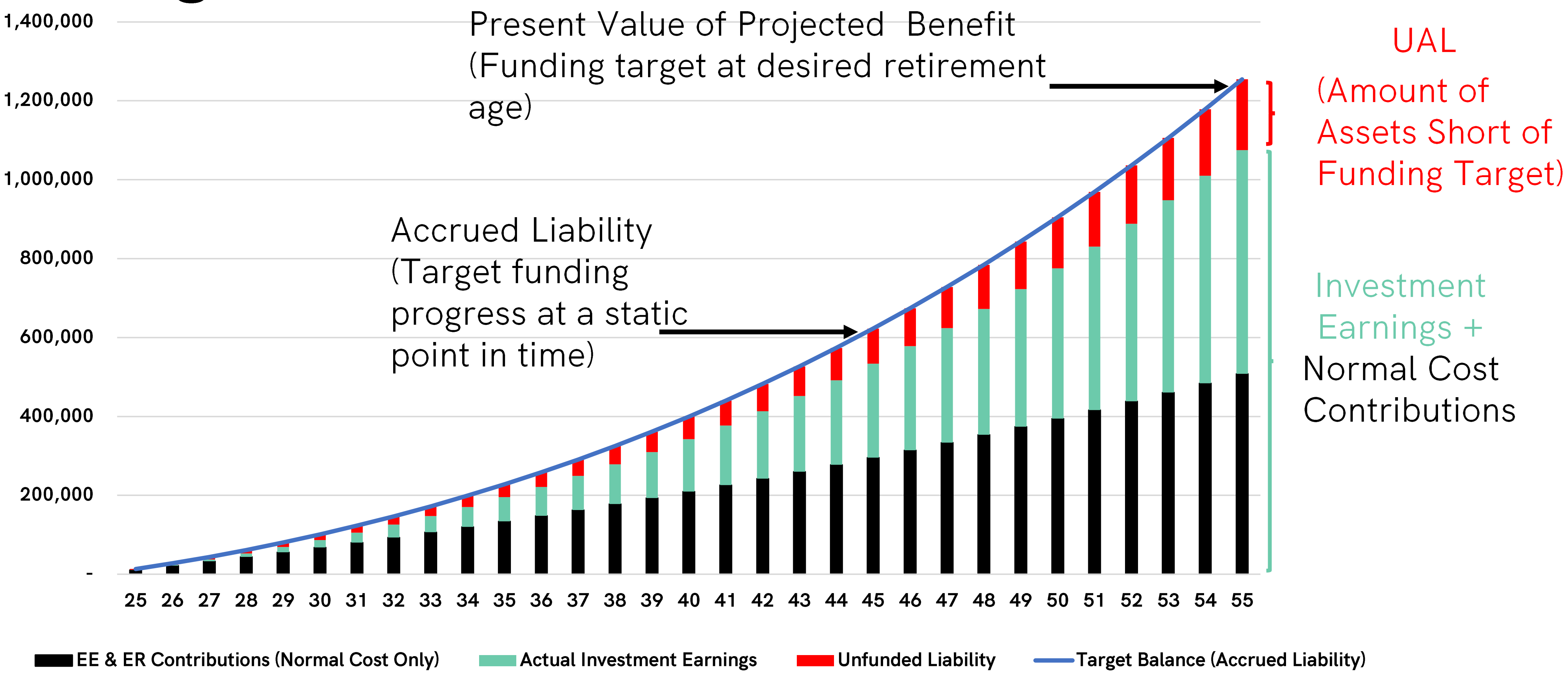
Retirement Plans Are Sensitive to Investment Earnings



Retirement Plans Are Sensitive to Investment Earnings



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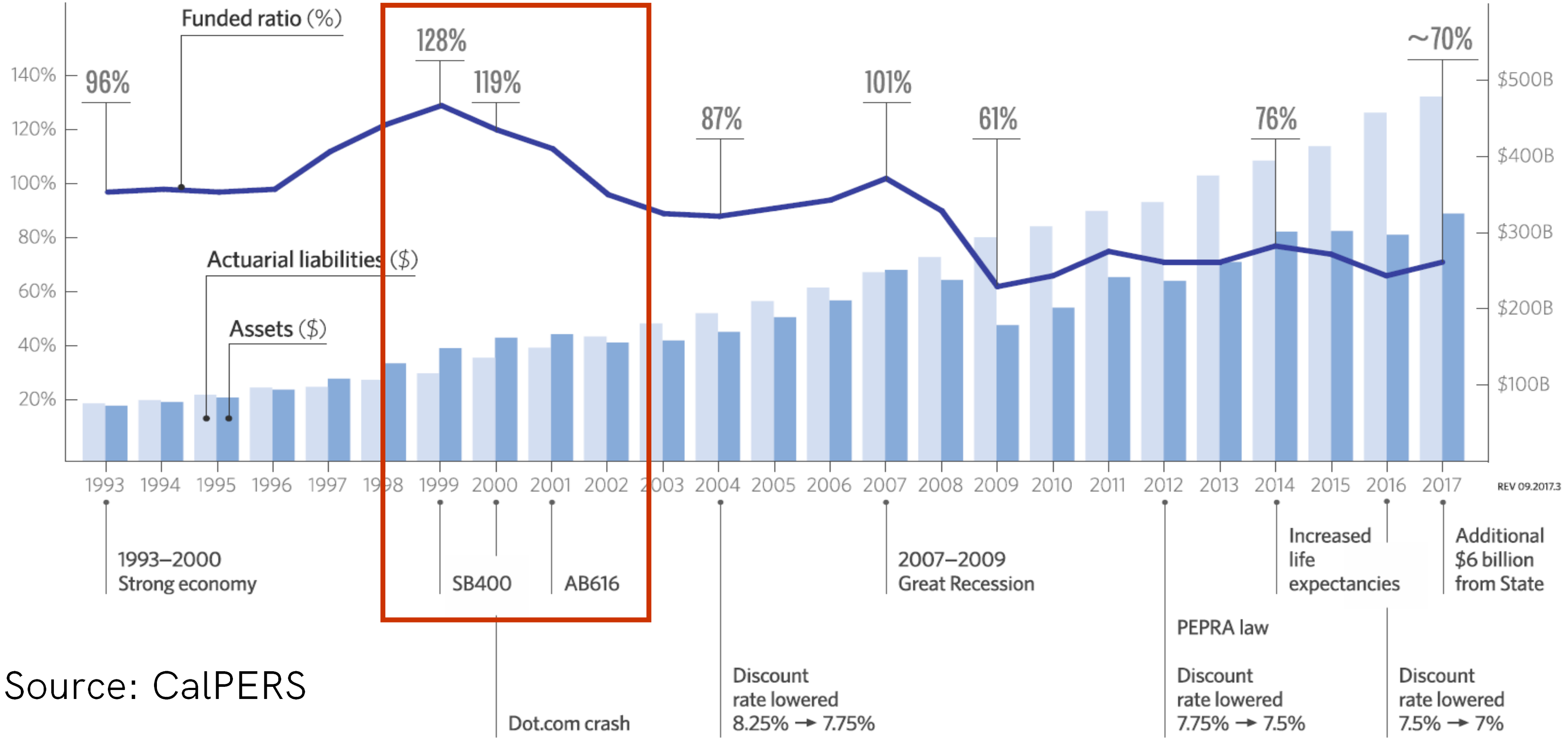
Historical Factors Impacting Funded Status



Source: CalPERS

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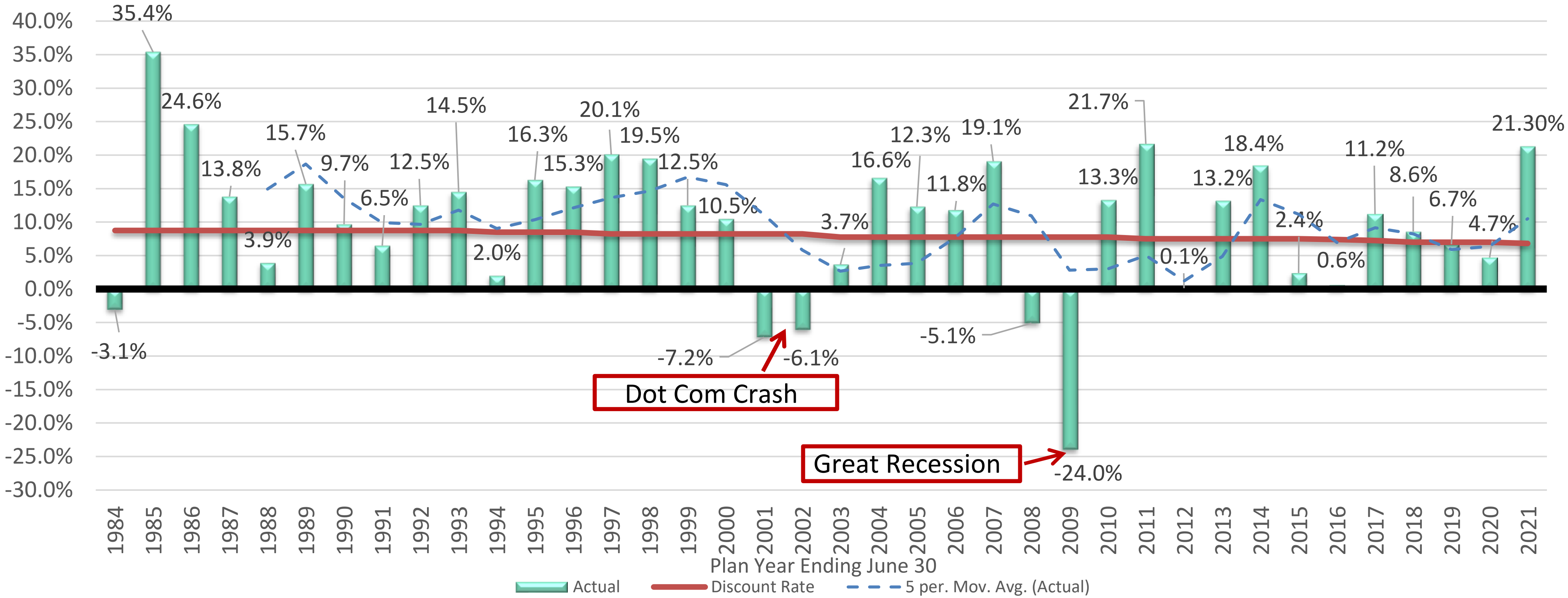
CalPERS Historic Investment Returns



Historical Compound Annual Rate of Return					
	1 Year	**5 Year**	**10 Year**	**20 Year**	**30 Year**
Compound Annual Return	21.30%	10.40%	8.50%	6.90%	8.40%

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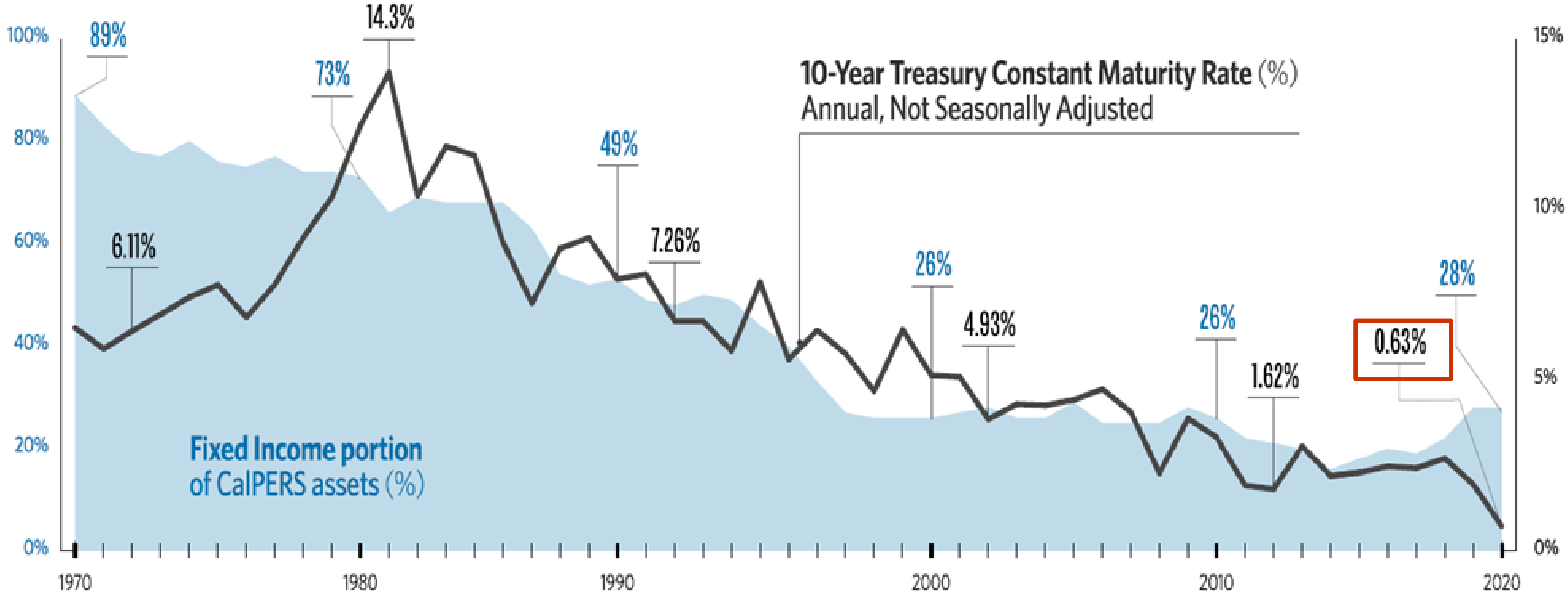
Challenges to Achieving Target Returns

US Treasury Yields Reduced to Near Zero

We Need to Take Risks to Achieve Returns



Source: CalPERS

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CalPERS Investment Return:

21.3%

(Preliminary Estimate)

Investment Return Triggers Lower Discount Rate Provision of Funding Risk Mitigation Policy

New Discount Rate of 6.8% approved November 2021

https://www.calpers.ca.gov/docs/funding-risk-mitigation-policy.pdf

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Funding Risk Mitigation Policy

Excess Investment Return	Reduction in Discount Rate	Reduction in Expected Investment Return
If the actual investment returns exceed the discount rate by:	*Then the discount rate will be reduced by:*	*And the expected investment return will be reduced by:*
2.00%	0.05%	0.05%
7.00%	0.10%	0.10%
10.00%	0.15%	0.15%
13.00%	0.20%	0.20%
17.00%	0.25%	0.25%

https://www.calpers.ca.gov/docs/funding-risk-mitigation-policy.pdf

Capital Market Survey

	Survey Parameter	2017 ALM*	2020 Mid-Cycle ALM Survey Median Value 03/31/20	2021 Initial ALM Survey Median Value 12/31/20	2021 Second ALM Survey Median Value 03/31/21
10-Year Expectations	Expected Return	6.1%	5.7%	4.9%	5.3%
	Expected Risk	11.4%	10.5%	11.5%	11.3%
	Expected Return/Risk	0.54	0.54	0.43	0.47
20-Year Expectations	Expected Return	7.0%*	6.6%	5.4%	6.2%
	Expected Risk	11.4%	10.5%	11.5%	11.3%
	Expected Return/Risk	0.73	0.63	0.47	0.55

Applying the survey results to our current portfolio mix, we do see lower expected returns and higher expected risk. Note the December 2020 survey results indicated a much steeper decline in our portfolio expected returns. This variability reflects both the degree of uncertainty in the projections, and the pace of events that influence those projections.

*The 2017 20-year expected return of 7.0% is the long-term blended expected return for years 1-60, which is made up of the 1-10 year expected return of 6.1% and the 11-60 year expected return of 8.3%.

Board Decisions

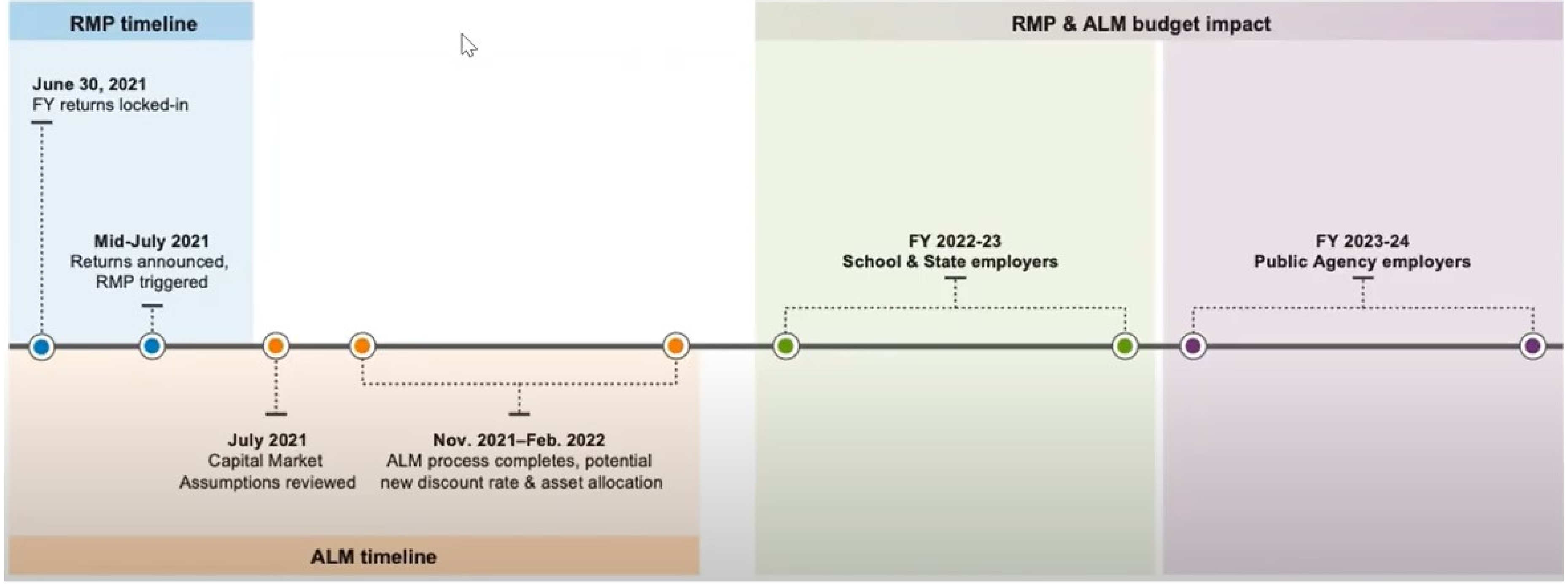
Reduced Discount Rate Assumption from 7% to 6.8%
Reduced Inflation Rate Assumption from 2.5% to 2.3%
Increased Wage Growth Assumption from 2.75% to 2.8%
Other Demographic Assumption Changes

[CalPERS Board Selects New Asset Allocation for Investment Portfolio, Keeps Discount Rate at 6.8% - CalPERS]

https://www.calpers.ca.gov/page/about/organization/facts-at-a-glance/asset-liability-management

What is Happening When?

- CalPERS Board adopted new discount rate November 2021 (6.8%)
- Assets and Liabilities Adjusted in 2021 Valuation
- Net Positive Impact to Funded Status
- Contribution Rate impact begins FY 23-24 for public agencies (Torrance)



How is Torrance Doing?

Plan Funded Status (Millions)

	6/30/2021					
Scenarios	Status Quo	A	B	C	D	E
Investment Return	7%	21.3%	21.3%	21.3%	21.3%	21.3%
Discount Rate	7%	7%	6.8%	6.5%	6.25%	6%
Mark Value of Assets (MVA)	$1,580	$1,760	$1,760	$1,760	$1,760	$1,760
Accrued Liability (AL)	$1,740	$1,740	$1,780	$1,850	$1,900	$1,960
Unfunded Liability (UAL)	$160	-$20	$20	$90	$140	$200
Funded Status (FS)	91%	101%	99%	95%	93%	90%

Scenario Notes:

A Favorable investment return increases MVA $180 Million and increases funded status 10% from status quo.

B Baseline: 6.8% discount rate increases AL $40 Million and reduces funded status 2% from scenario A (Favorable Investment Return).

C 6.5% discount rate increases AL $110 Million and reduces funded status 6% from scenario A (Favorable Investment Return).

D 6.25% discount rate increases AL $160 Million and reduces funded status 8% from scenario A (Favorable Investment Return).

E 6.0% discount rate increases AL $220 Million and reduces funded status 11% from scenario A (Favorable Investment Return).

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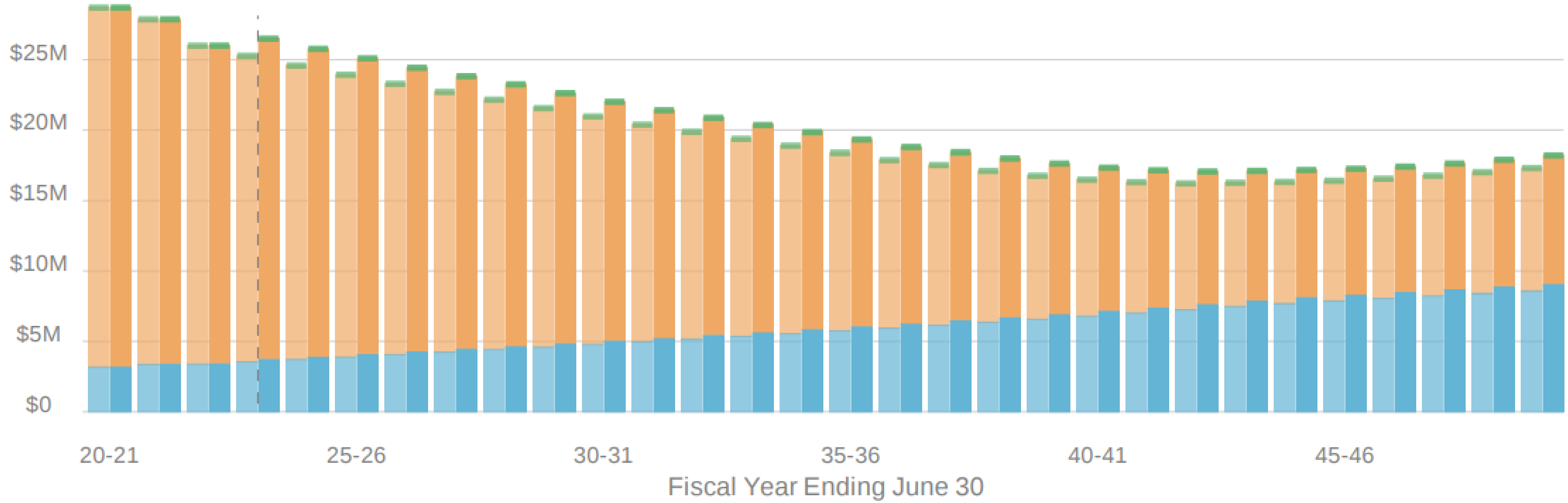
Normal Cost – 7.0% vs 6.8% Discount Rate

Total Normal Cost	Employee Contributions	Employer Normal Cost
$26.49M	$3.68M	$22.81M
from $25.28M	from $3.54M	from $21.74M
$1.21M	$140.03K	$1.07M



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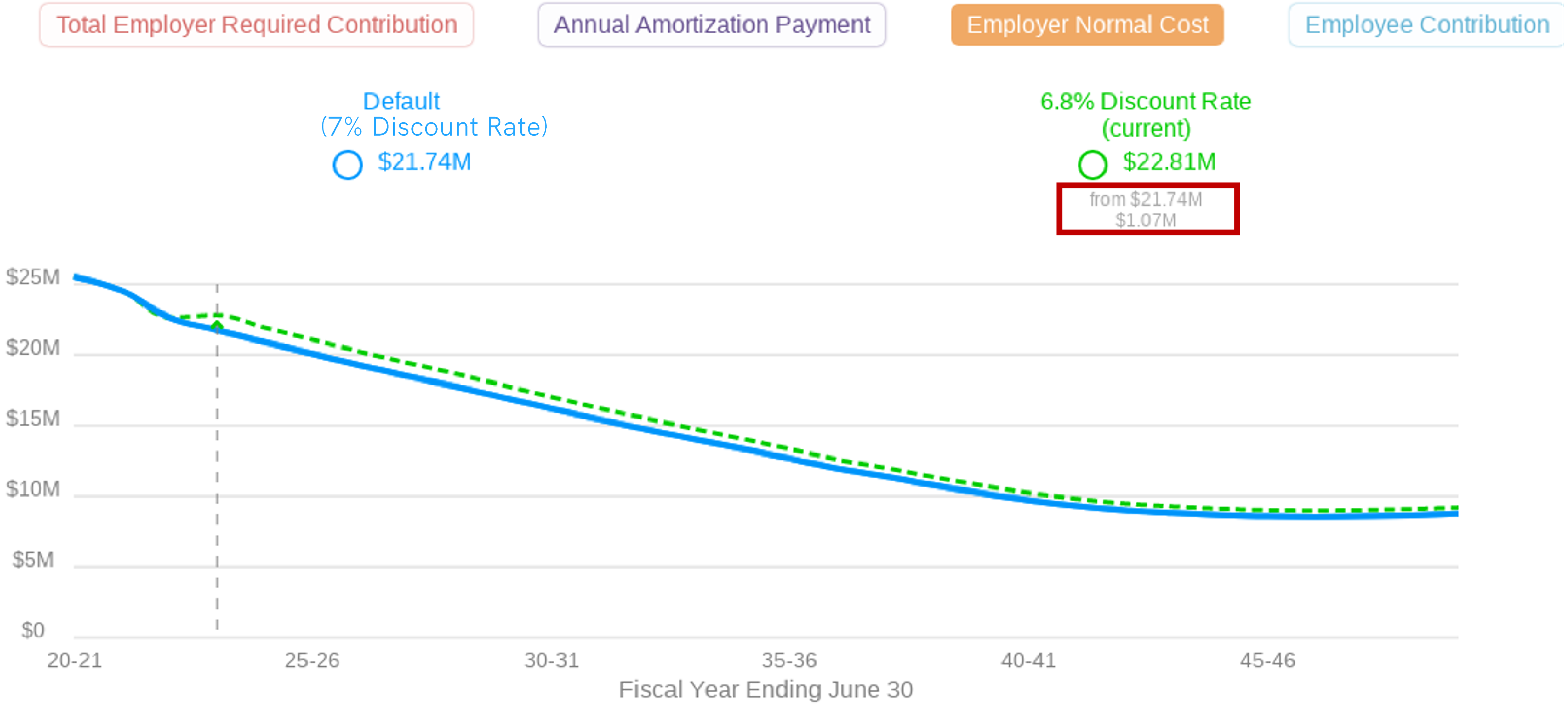
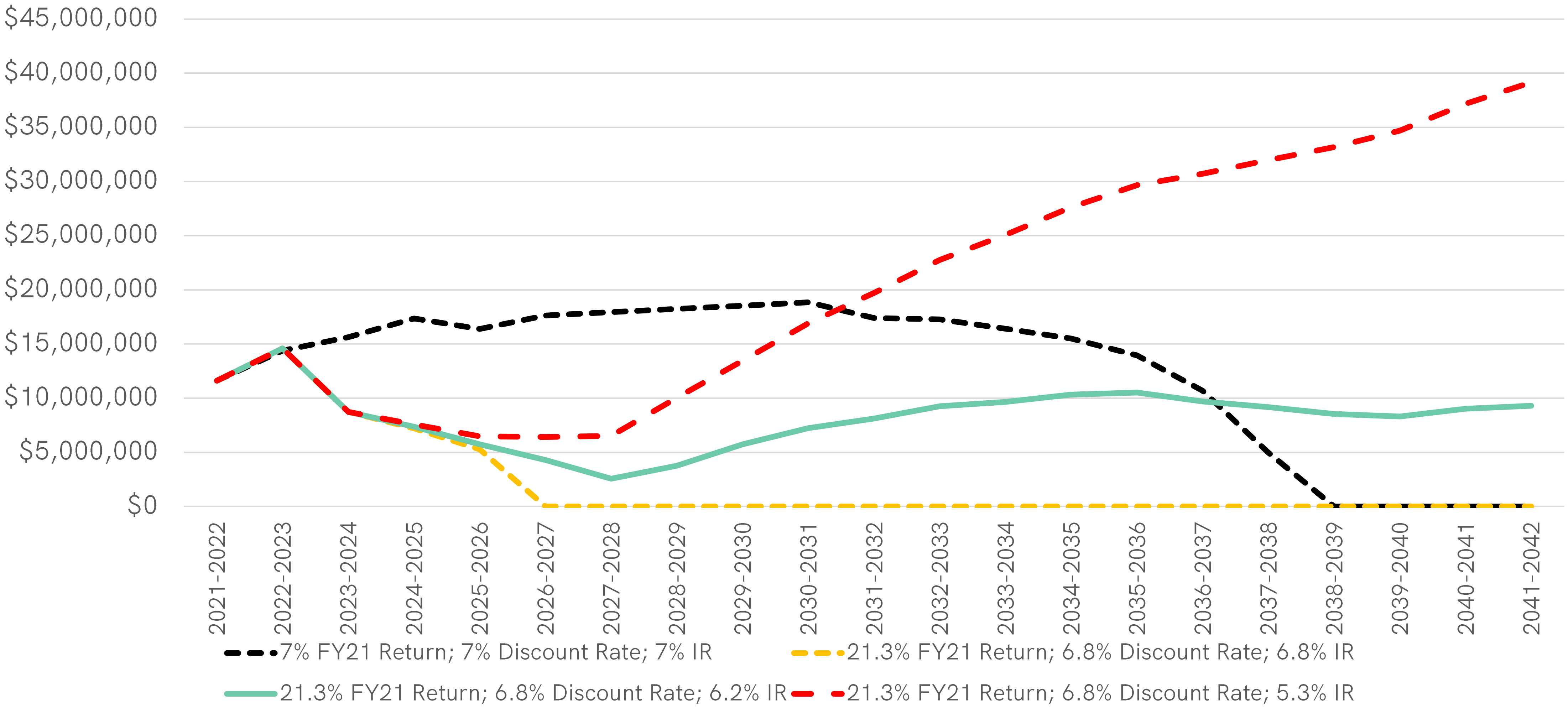
Employer Normal Cost (without Employee Contributions) – 7% vs 6.8% Discount Rate



Unfunded Accrued Liability (UAL) Contribution



* Does not include Lease Revenue Bond payment of $18.3 million

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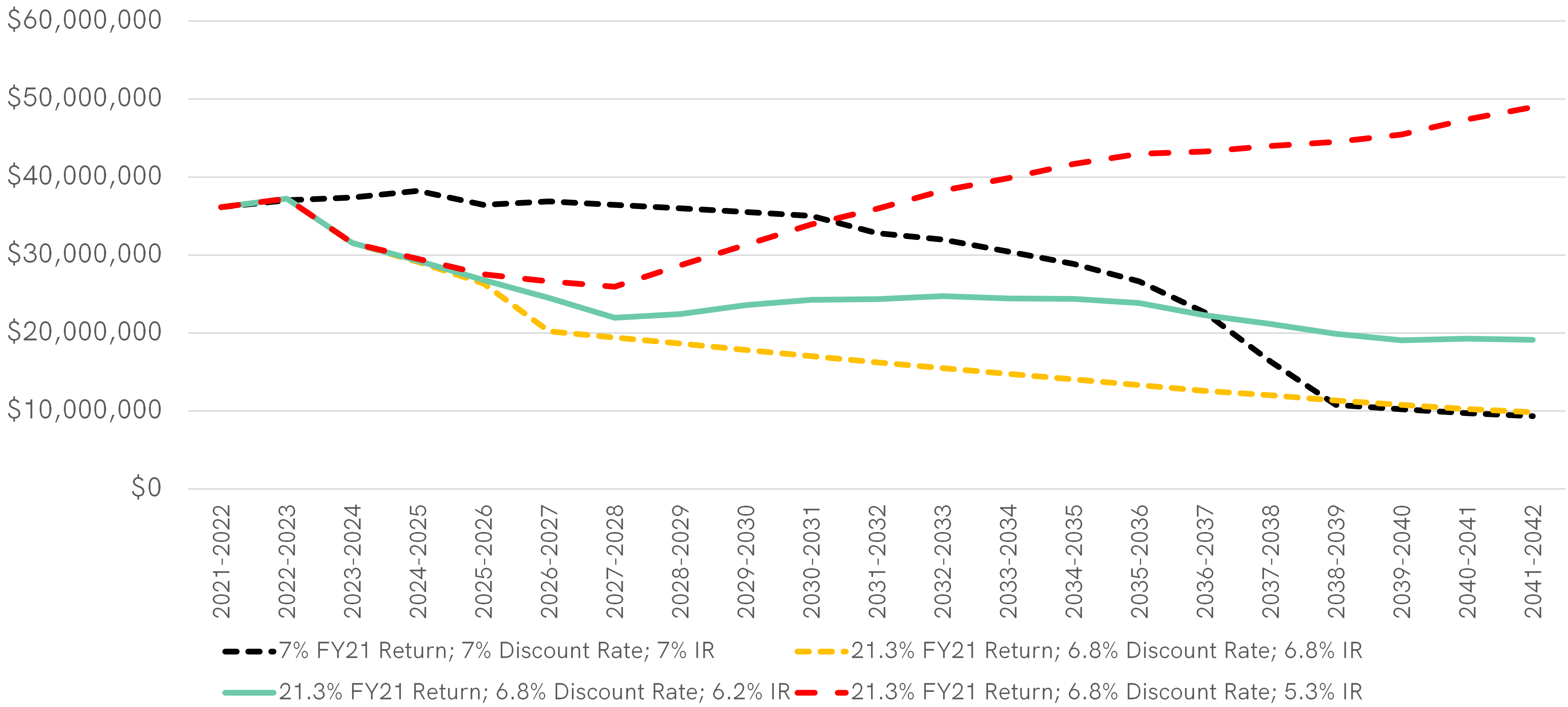
Total Employer Contribution – CalPERS only



* Does not include annual Lease Revenue Bond payments

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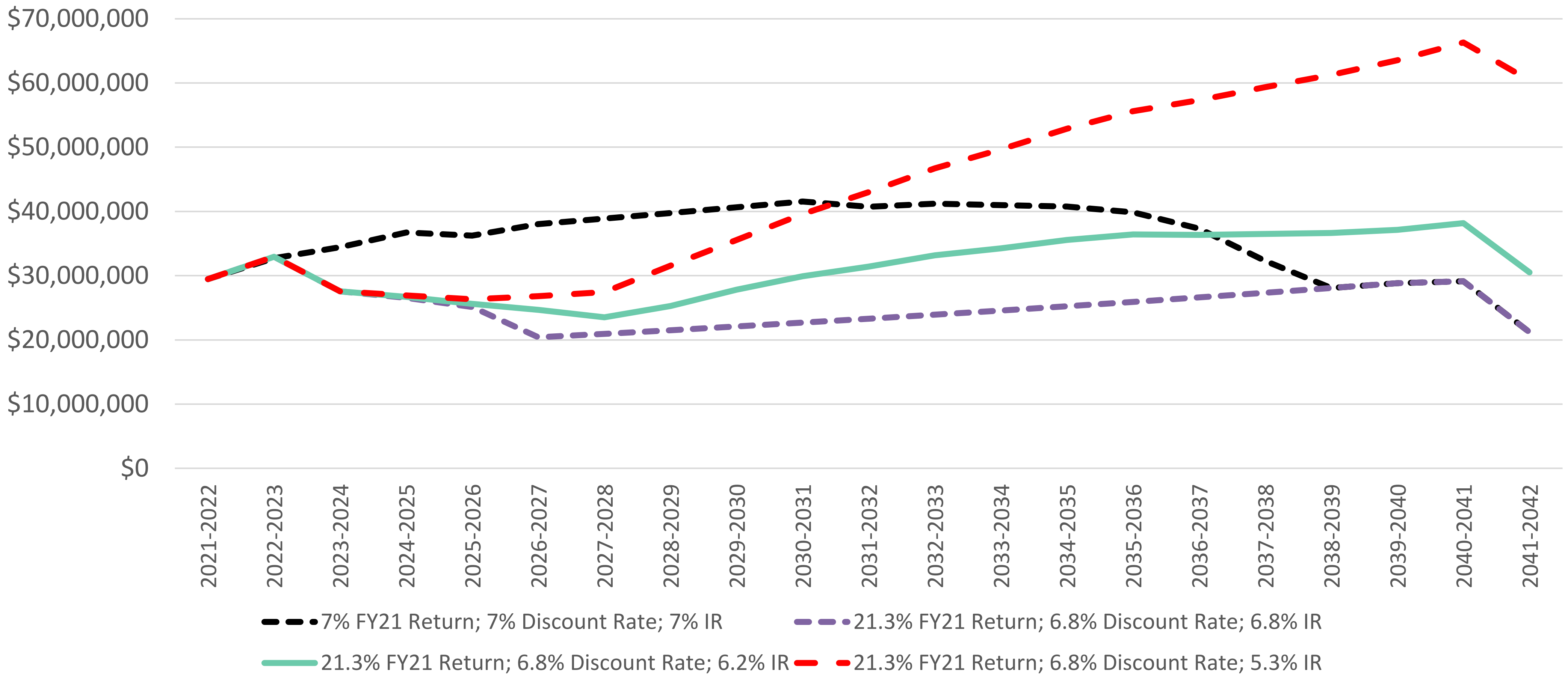
Total Employer Contribution – CalPERS & LRBs



* Includes all annual Lease Revenue Bond payments

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Questions

Disclaimer

While tested against actuarial valuation results, the software results will not necessarily match actuarial valuation results, as no two actuarial models are identical. The software offers financially sound projections and analysis; however, outputs do not guarantee compliance with standards under the Government Accounting Standards Board or Generally Accepted Accounting Principles. The software and this presentation are not prepared in accordance with standards as promulgated by the American Academy of Actuaries, nor do outputs or this presentation constitute Statements of Actuarial Opinion. GovInvest has used census data, plan provisions, and actuarial assumptions provided by Customer and/or Customer's actuary to develop the software for Customer. GovInvest has relied on this information without audit.

Reference Material

Resource Links

CalPERS Asset Liability Management (ALM) Resource Page
https://www.calpers.ca.gov/page/about/organization/facts-at-a-glance/asset-liability-management
CalPERS Asset Liability Management (ALM) March 15 Stakeholders Forum Video – Risk Concepts & Examples
https://www.youtube.com/watch?v=EYOetWyKDwc

CalPERS ALM Risk Concepts and Examples PDF
https://www.calpers.ca.gov/docs/board-agendas/202103/invest/item08a-01_a.pdf

CalPERS September 13 Investment Committee Video – Candidate Portfolios
https://www.youtube.com/watch?v=cbcogSp3X5E&t=274s

CalPERS September 13 Investment Committee -Candidate Portfolio PDF
https://www.calpers.ca.gov/docs/board-agendas/202109/invest/item08a-01_a.pdf

Source: CalPERS